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**Review of the efficiency of the administrative and financial functioning
of the United Nations**

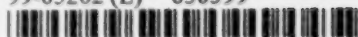
**Administrative and budgetary aspects of the financing of the
United Nations peacekeeping operations**

**Report of the Secretary-General on the activities of the Office of Internal
Oversight Services**

Report of the Office of Internal Oversight Services on the review of procurement-related arbitration cases

Note by the Secretary-General

1. Pursuant to General Assembly resolution 48/218 B of 29 July 1994, the Secretary-General has the honour to transmit, for the attention of the General Assembly, the attached report, conveyed to him by the Under-Secretary-General for Internal Oversight Services, on the review of procurement-related arbitration cases.
2. The Secretary-General takes note of its findings and also notes that some of the recommendations may require additional resources for full implementation by all departments concerned. Careful study will be given to each such case, and full justification will be provided through the normal budgetary mechanism if warranted.



Summary

A. Introduction

The General Assembly, in its resolution 52/226 A of 31 March 1998, requested the Secretary-General to entrust the Office of Internal Oversight Services (OIOS) with conducting a comprehensive review and analysis of procurement-related arbitration cases and to report to the Assembly at its fifty-third session on measures to be taken.

OIOS reviewed five procurement cases involving total claims of approximately \$52.6 million. All of those cases, which became subject to arbitration or negotiated settlement between 1995 and 1997, were related to peacekeeping operations established in the early 1990s, a period marked by a dramatic surge in peacekeeping activities. Of the \$52.6 million in claims, a total of \$23 million was awarded by arbitration tribunals, and \$3.75 million was paid in settlements to contractors.

B. Results in brief

Although the arbitration and settlement awards constituted a relatively small part of procurement contract costs, OIOS noted that the Organization incurred substantial interest as well as legal and staff costs related to those disputes. About \$4.8 million was paid in interest charges related to delayed payments resulting from disputes and \$2.3 million was spent on legal services and other arbitration costs. OIOS considers arbitration to be a costly method of dispute resolution, and one that can produce unpredictable results. It should be prevented to the extent possible through improved contract preparation and administration.

The review, as well as previous OIOS audits, showed that during the rapid expansion of peacekeeping operations between 1992 and 1995, the Organization did not have the necessary human resources and expertise to provide sufficient logistical and administrative support to peacekeeping missions. As a result, contracts were often administered by individuals from military contingents who did not have the necessary training and experience. The other main findings of the review included the following:

(a) Consultation among Headquarters units and mission personnel was inadequate and not timely;

(b) Field procurement personnel in some cases did not comply with procurement rules and procedures;

(c) Contract terms were not always clear and were sometimes accepted and subsequently changed without consultation and review by the Headquarters Committee on Contracts or the Office of Legal Affairs;

(d) Undisputed charges were occasionally not paid in a timely manner, resulting in payment of substantial interest costs on the amounts withheld;

(e) Vendor performance was not routinely evaluated and performance problems were not always documented and communicated to contractors;

(f) Damages resulting from third-party actions were not always charged to those parties;

(g) Arbitration and settlement activities were not systematically evaluated to identify and disseminate lessons learned.

C. Recommendations

To address those shortcomings, OIOS recommends that:

(a) Peacekeeping missions, especially in the early stages, be staffed with qualified, experienced procurement and contract administration personnel and legal advisers;

(b) Administration in the field and at Headquarters ensure that material deviations from contracts are documented and brought to the attention of Headquarters officials as necessary;

(c) Vendor performance be routinely evaluated and unsatisfactory performance fully documented so that such information can be used in procurement decision-making;

(d) All aspects of arbitration and settlement cases be reviewed to ensure that possible claims against third parties have been considered and lessons learned have been identified and disseminated.

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I. Introduction

1. The present report responds to General Assembly resolution 52/226 A of 31 March 1998, in which the Assembly requested the Secretary-General to entrust the Office of Internal Oversight Services (OIOS) with performing a comprehensive review and analysis of procurement-related arbitration cases and to report to the Assembly during its fifty-third session on measures to be taken.

2. All United Nations contracts contain a standard clause providing that contract disputes, unless settled amicably, shall be referred by either party to arbitration in accordance with the Arbitration Rules of the United Nations Commission on International Trade Law, as recommended in General Assembly resolution 31/98 of 15 December 1976. Normally, the parties negotiate to resolve any disagreements, since the United Nations seeks to settle disputes amicably. However, under the dispute settlement clause currently used in United Nations contracts, when negotiations fail, the claiming party can refer the case to arbitration within 60 days of a request for such settlement. The arbitration proceedings are governed by the rules mentioned above and the arbitral agreement between the parties. The parties can agree on a single arbitrator, or each can appoint an arbitrator who will select a third arbitrator. All arbitration awards are final and binding on both parties.

3. According to the records of the General Legal Division, Office of Legal Affairs, legal action had been initiated against the United Nations in 12 procurement cases between 1995 and September 1998. The status of the cases initiated against the Organization by contractors at the time of the OIOS review was as follows:

(a) Five cases with claims totalling \$52.6 million had been resolved through arbitration and negotiations, including two cases involving claims of \$11.9 million that were settled through negotiations;

(b) Three cases totalling \$32.3 million were in arbitration or negotiations;

(c) One case, involving a claim of \$590,000, was withdrawn by the contractor;

(d) One case, involving \$11.2 million, was awaiting arbitration proceedings;

(e) Two claims totalling \$190.7 million were the subject of lawsuits that were dismissed; in one case (\$700,000), the claimant indicated an intention to appeal the dismissal; the other claim (\$190 million) is likely to proceed to arbitration soon.

4. All of the above cases relate to peacekeeping operations between 1992 and 1995, when there was an extraordinary surge in peacekeeping activities. The rapid deployment of often volatile peacekeeping operations presented an unprecedented challenge to the Organization in selecting reliable contractors, preparing contracts and subsequently managing their implementation.

5. Total expenditures during the period from January 1992 to June 1997 in the five major peacekeeping missions where contract disputes arose exceeded \$5.3 billion. Disputes with contractors involved the following areas: supply of rations and potable water; distribution of fuel; air operations; and various other services. Total procurement expenditures in those areas amounted to \$594 million. As shown in paragraph 3, the arbitration claims submitted by contractors amounted to \$96.7 million, or 16 per cent of the total expenditures in those areas. Arbitration awards and settlements have cost the Organization \$26.7 million, or 51 per cent of the amounts initially claimed in the five settled cases. Legal and arbitration fees amounted to \$2.3 million, and interest on delayed payments totalled \$4.8 million.

6. OIOS, in its previous reports to the General Assembly and management concerning the rapid growth in peacekeeping missions, highlighted a number of critical issues, including: (a) shortages of qualified personnel at the field mission level to perform administrative functions (procurement, personnel, finance, logistics); and (b) insufficient resources for support units at Headquarters, including the Field Administration and Logistics Division (formerly the Field Operations Division) of the Department of Peacekeeping Operations and the Procurement Division (formerly the Purchase and Transportation Service) of the Department of Management to expeditiously satisfy mission requirements. Determining requirements on such a large scale was a new task for those support units. Under those circumstances, key contract administration functions in the field in many cases had to be entrusted to military personnel provided by Member States. Those personnel, although competent in their respective functions, were not familiar with the Organization's procurement and contract management procedures. They also could not be held accountable for their actions by the Organization.

7. For purposes of the present report, OIOS reviewed the five procurement cases that were resolved through arbitration or settlement. The four cases currently under arbitration or settlement negotiations were not reviewed, as the findings of OIOS could prejudice their outcome. Similarly, OIOS did not review the case withdrawn by the contractor or the two claims that were the subject of lawsuits. Also, the engagement of outside legal counsel to

represent the Organization in arbitration cases was excluded from the scope of the present review, as that issue had already been reviewed by the Board of Auditors in October 1997. Numerous other claims resulting from peacekeeping operations and reviewed by local and Headquarters claims review bodies were also not included. Management's comments were sought on the draft report and were taken into account in preparing the final report. The names of contractors and designations of the contracts were not revealed in the present report, as that information, under the arbitration rules, cannot be made public without the consent of the parties involved.

II. Review of resolved cases

A. Supplying rations and potable water to mission A

1. Contractual dispute

8. In January 1994 the Organization entered into a contract for the provision of rations and potable water from January to December 1994 to military contingents assigned to mission A for an amount not to exceed \$56.3 million. In the opinion of OIOS, making contract ceiling amounts known to contractors (which was the case for all contracts reviewed) is not a prudent practice. *The Office of Legal Affairs noted that this was a common practice, which was necessary to protect the Organization from potentially opened financial liabilities.* However, OIOS points out that, as shown by the arbitration cases, the financial liability of the Organization is actually determined by the quantity of the goods and services received under the contract and their contractual prices, irrespective of any contract ceiling amount communicated to the contractors.

9. Because the contractor that submitted the lowest bid did not comply with the financial requirements stipulated in the request for proposal with respect to net assets, and because of information that cast doubt on the company's reputation, the contract was considered by a specially convened Headquarters Committee on Contracts composed of several senior officials. In view of the critical needs of the mission, this Committee approved the contract but recommended that the company provide a performance guarantee of \$5 million.

10. The mission made a number of complaints about the contractor's performance, which the Department of Peacekeeping Operations communicated to the Purchase and Transportation Service in May 1994. However, that

information was neither complete nor sent in a timely and consistent manner. Therefore, no formal notice of non-compliance was filed with the contractor. In the meantime, the mission tried to resolve the issues through direct negotiations with the contractor.

11. In July 1994 the contractor notified the Organization that it believed that the United Nations had breached essential parts of the contract. The contractor submitted claims totalling \$12.4 million and gave notice of its intention to terminate the contract. The claims were based mainly on the following factors: (a) the number of troops to be provided with rations was only 19,000 against the estimated 29,000 on which the contractor had based the original contract pricing; (b) the mission ordered only 50 per cent of its potable water from the contractor; and (c) contract prices had not been reviewed after six months as stipulated in the contract. The Organization presented its counter-claims to the contractor, consisting of \$1.5 million for rations it handed over to the contractor at contract inception and amounts deducted because of various complaints about the quality of rations and services delivered by the contractor.

12. In August 1994, the Headquarters Committee on Contracts endorsed the following three-part recommendation, which had been developed by various Headquarters units: (a) negotiate a settlement agreement with the contractor; (b) if negotiations fail, issue a new request for proposal to other contractors currently providing satisfactory services to peacekeeping missions; or (c) in case of successful negotiations but continued unsatisfactory performance by the contractor (making extension of the existing contract unwarranted), issue a request for proposal for a new contract to take effect on 1 January 1995.

2. Settlement agreement

13. After extensive negotiations in which the Organization was represented by officials of the Purchase and Transportation Service, the Field Operations Division and the General Legal Division, the parties developed a settlement proposal involving a net payment of \$4.8 million to the contractor in full and complete settlement of the contractor's claims and the Organization's counter-claims. By the date of the final version of the settlement agreement, the United Nations had determined that the contractor's services would not be needed after the expiration of the contract in January 1995. The settlement agreement included various transitional provisions applicable from 1 November 1994 until the expiration of the contract, including an upward revision of contract prices. The negotiated settlement agreement also included a complete release by the contractor

of any and all claims arising from or in any way connected with the contract, as well as a release by the United Nations of its counter-claims against the contractor.

14. According to the General Legal Division, its preliminary legal analysis of the contractor's claims showed ambiguities in certain technical provisions of the contract (e.g., relating to the number of troops to be provisioned, water requirements to be met by the contractor and renegotiation of prices in the event of inflation), which would have allowed the contractor to engage the Organization in lengthy and costly arbitration. In addition, the General Legal Division found that the Organization had failed to adhere strictly to the multitude of notice requirements in the contract. In its briefing note of 11 November 1994, the Division concluded that the settlement would avoid costly and lengthy arbitration of the claims and would ensure uninterrupted services to the mission until its end. Another argument supporting the settlement was that total payments already made to the contractor (\$36.3 million) plus the settlement amount (\$4.8 million) and the estimated firm cost of the renewed contract (\$14.2 million) would amount to \$55.3 million, still below the \$56.3 million ceiling price of the original contract.

15. The proposed settlement agreement was submitted to the Headquarters Committee on Contracts, which in November 1994 expressed concerns about the size of the settlement in relation to the services provided by the contractor and the contractor's high profit margin resulting from the revised contract for the period from 1 November 1994 to 31 March 1995. The Committee recommended that the settlement payment be made in instalments to ensure that the contractor would comply with the terms of the new contract.

16. The Headquarters Committee on Contracts also made the following general recommendations:

(a) Such situations should be prevented in the future through proper planning and by avoiding ambiguities in requests for proposals and contracts;

(b) The Department of Peacekeeping Operations, the Purchase and Transportation Service and field missions should ensure compliance with all provisions of existing contracts, especially those concerning proper notification;

(c) The Office of Legal Affairs should review the new agreement so that it and the settlement agreement can be concluded with the contractor simultaneously.

OIOS concurs with the Committee's recommendations, and notes that the first two recommendations apply to all procurement contracts.

17. After the settlement and the amended contract had been negotiated, the Field Operations Division of the Department of Peacekeeping Operations and the mission determined that the contractor's services would not be required after 1 January 1995 except for warehousing available stocks and making outstanding deliveries. On 22 December 1994 the contractor submitted a merged version of the contract and the settlement agreement to the Organization for acceptance by 30 December 1994. At a subsequent meeting, the heads of the concerned Headquarters units decided that the deadline could not be met since necessary approvals and funding documentation had to be obtained and because the agreement had to be presented again to the Headquarters Committee on Contracts. As a result, the General Legal Division advised that if the Purchase and Transportation Service and the Field Operations Division considered the negotiated text appropriate, the Acting Chief of the Purchase and Transportation Service should conditionally sign the settlement agreement with a notation that his signature was subject to approval pursuant to the Financial Regulations and Rules of the United Nations. The Chief of the Purchase and Transportation Service did so, and on 30 December 1994 forwarded the conditional agreement to the contractor. The contractor disagreed with the conditional signing, maintaining that this qualification had no legal basis and that the settlement agreement was legally binding on the Organization.

18. In a memorandum to the General Legal Division dated 30 December 1994, the Chief of the Purchase and Transportation Service stated that the Service was currently reviewing the settlement agreement in order to make a recommendation to the Committee on Contracts, and requested the Division to provide the rationale of the settlement agreement. The General Legal Division provided this rationale on 5 January 1995. Although the Purchase and Transportation Service was an active participant in the Organization's negotiating team, the Officer-in-Charge of the Service, in a memorandum dated 6 January 1995, stated that it was unable to determine whether the Organization owed the settlement sum to the contractor or, if it did, on what basis the claim and calculations were actually made. Thus, there was no concurrence among the various Secretariat units regarding the appropriateness of the settlement agreement. Lacking internal consensus, the agreement was not submitted to the Headquarters Committee on Contracts for approval.

19. The contractor continued supplying food rations and potable water until April 1995, and submitted invoices based on rates agreed to in the settlement agreement. However, the Organization had concluded that the settlement agreement

was not binding, as the condition under which it had been signed had not occurred. Therefore, it made payments based upon the original contract.

20. OIOS reviewed the terms of the settlement agreement in January 1995 and, in a report dated 27 February 1995, highlighted the absence of complete justification for the settlement because the original contract did not obligate the Organization to ensure that a minimum number of troops be supplied with rations, procure all potable water only from the contractor or review the prices after six months. As noted in paragraph 14 above, on the basis of its legal analysis of the contract, the Office of Legal Affairs had identified ambiguities that could have led to lengthy and costly arbitration. OIOS recommended that further clarification and explanation be obtained from the mission. Those recommendations could not be fully implemented because the mission had closed and most of its personnel and the liquidation team had already departed.

21. In commenting on the above-mentioned OIOS report, the Office of Legal Affairs explained that the settlement agreement was based on fair and reasonable terms and two other motivating factors. First, the Organization would avoid terminating the contract, which would have necessitated back-up arrangements, which, according to the General Legal Division, would have been less than optimal, with attendant disruption to the mission. Second, it was considered preferable to resolve the claims for a sum certain rather than to litigate the various claims and defences in arbitration, which could have resulted in considerable cost to the Organization as well as risking potentially higher financial liability if arbitration of claims resulted in an unfavourable award against the Organization. The Division also stated that after the notification of 27 July 1994 and after a 21-day period, the contractor could have terminated services to the mission with 7 days' notice. The contractor had threatened such action during settlement discussions.

22. In March and April 1995, at the request of the Field Administration and Logistics Division, OIOS reviewed all invoices submitted by the contractor for food rations and potable water supplied to the mission. As a result, OIOS commented on a number of irregularities in the procurement and delivery process, and questioned the quantities of some food items claimed to have been delivered by the contractor. OIOS also noted that rations and water delivered after 1 November 1994 were invoiced in accordance with the settlement agreement, which was not considered valid by the Organization, and found that some of the invoices for services not included in the contract were signed as received by mission military officers, who were not authorized to do

so. OIOS requested further clarification and supporting documentation regarding a number of transactions.

23. On 18 January and 16 March 1995, the Organization made two payments totalling \$9.2 million to the contractor for amounts that the Department of Peacekeeping Operations determined, on the basis of the pricing system in the original contract, were owed on unpaid invoices. The Organization reserved its rights with respect to the additional and contested amounts claimed by the contractor. Since the ensuing negotiations failed to resolve differences, the contractor instituted arbitration proceedings against the United Nations.

24. The contractor submitted claims totalling \$29.6 million. This included \$4.8 million payable under the settlement agreement, \$6.6 million for food supplied during November and December 1994, \$3.3 million for stock taken over at the expiration of the contract, \$7.4 million for various other supplies and services and \$7.5 million for damages and arbitration costs. The contractor's claims were made in gross amounts for some of the supplies and services, even though the Organization had already paid the contractor for those items at the original contract prices. The contractor also asserted that if the validity of the settlement agreement was not upheld, the additional amount payable by the Organization for goods and services as per the original claim submitted before the settlement would be about \$12.4 million, not \$4.8 million as agreed to in the settlement.

25. However, the Organization maintained that the settlement agreement could not be considered valid and that the only valid document governing the relationship with the contractor was the original contract, and accordingly rejected all claims for goods and services that were not in accordance with the original contract. In addition, the Organization submitted counter-claims against the contractor totalling about \$5.3 million, which included \$1.6 million for the value of food stocks handed over to the contractor at the beginning of the contract, \$1.5 million for the cost of equipment misappropriated or damaged by the contractor and more than \$2 million for amounts over-billed.

3. Arbitration Award

26. In a July 1996 interlocutory award, the arbitration tribunal determined that the settlement agreement, although entered into conditionally by the Organization, was indeed valid and that the settlement amount of \$4.8 million should be paid to the contractor as per the agreement, and all goods supplied and services rendered subsequent to the agreement by the contractor should be settled in accordance with the terms of that agreement. One of the arbitrators dissented

from the tribunal's ruling that the settlement agreement was valid and binding. In late 1996, prior to the main hearings before the tribunal, the Organization had initiated discussions with the contractor to explore the possibility of settling the case. Considering the exposure to liability and the costs of proceeding with evidentiary hearings, the Organization made a settlement offer that included a lump-sum payment of \$10.5 million. However, the offer was rejected by the contractor.

27. The final award, paid in April 1997, did not fully compensate the additional claims submitted by each party, and some of the claims were not compensated at all. The contractor was awarded the following (in gross amounts, including the \$9.2 million previously paid by the Organization):

(a) \$6.7 million for the value of goods supplied in November and December 1994;

(b) \$3.3 million for the value of goods taken over from the contractor by the Organization, as agreed to by both parties after the interlocutory award;

(c) \$2.5 million against the claim of \$7.3 million for various supplies and services;

(d) \$1.5 million in interest on the awards made to the contractor, calculated at the New York statutory rate of 9 per cent.

However, the contractor's claims for punitive damages, lost profits, attorney's fees and arbitration costs, totalling \$7.5 million, were rejected. Also, approximately \$4.5 million in claims for various supplies and services were rejected. Thus, the tribunal rejected claims by the contractor totalling about \$12 million.

28. At the time of the arbitration proceedings, OIOS was informed that the contractor was in possession of certain United Nations equipment that was the subject of a counter-claim by the Organization. Following a preliminary investigation by OIOS, the United Nations filed a formal complaint with the Government of the country where the equipment was found during a police search on vessels owned and/or operated by the contractor. The country authorities filed criminal charges of theft and possession of United Nations-owned equipment against four contractor officials. The Organization was advised that pursuing its arbitration counter-claim for those items could prejudice the criminal case and would likely prevent it from being pursued by prosecutors. In view of the Organization's policy to pursue alleged criminal acts committed against it and to recover stolen assets, as well as the Organization's obligation to cooperate with Member States to facilitate the

proper administration of justice, those items, worth approximately \$400,000, were withdrawn from the counter-claim.

29. The Organization's counter-claims for compensation regarding supplies not meeting contract specifications were rejected because they were already included in the settlement agreement. However, it was awarded \$222,910 plus interest against a claim of \$3.3 million. The Organization also paid \$1.3 million in legal fees and \$130,000 as its share of the arbitration costs. In addition, substantial staff resources were used in the arbitration process. The criminal case referred to in paragraph 28 above is still ongoing.

B. Additional supplies of potable water to mission A

30. Initially, the contractor discussed in the case of mission A above could not supply potable water to the mission. Later, when the water was delivered, part of it was rejected by military contingents on health grounds, although the water had passed tests based on World Health Organization standards. Consequently, in March 1994 the mission issued a purchase order to another vendor for an urgent supply of 93,516 cases of mineral water costing \$527,430.

31. The mission procurement section had also requested the vendor's agent to arrange preparations for another shipment of mineral water before 26 June 1994, indicating in a letter that a purchase order would follow. A trial print purchase order for 225,000 cases of mineral water was issued to the vendor, who regarded the trial print purchase order together with the letter as constituting a bona fide order. A partial first shipment in July 1994 of 93,516 cases was eventually accepted by the mission, which informed the vendor's agent that it would accept no further deliveries. The vendor attempted to deliver a further 131,000 cases of water in September 1994. However, this delivery was rejected by the mission's newly appointed procurement management because the mission had not placed a formal order.

32. The vendor and its agent filed a claim for \$1,269,000 in respect of the disputed mineral water. Attempts to settle the claim, together with a separate claim of \$1,260,574 for demurrage charges for unreturned containers, were unsuccessful because the parties could not agree on the demurrage charges, and the vendor insisted on full payment for the mineral water that had been delivered. As a result, no payments were made to the vendor.

33. In December 1996, a statement of claim for \$9.2 million was filed by legal counsel representing both the vendor and his agent. Claimants demanded payment for bottled water, container charges (demurrage and replacement cost for unreturned containers), interest and incidental and punitive damages. After arbitration proceedings commenced, a settlement agreement was reached in November 1997 whereby the claimants were to receive compensation of \$2.5 million in full and final settlement of all claims. The Organization's expenses, including fees for outside counsel and members of the arbitration tribunal, amounted to approximately \$240,000.

34. Although the settlement statement precluded future claims for this issue by the claimants, it did not protect the Organization from future claims for containers owned by third parties and rented to the claimants. The claimants' counsel informed the Organization that there was no insurance coverage and no such claims had been filed, but this was not made as a formal statement. The Organization attempted to negotiate into the settlement agreement a provision protecting it from future claims for containers owned by third parties. However, the parties were unable to reach agreement on such a provision.

35. The main issue in this case involved non-compliance with established procurement procedures by the mission's chief procurement officer. Although the precise cause for the non-compliance could not be determined, OIOS believes that a more professional approach to this procurement action could have averted significant financial losses.

C. Fuel storage and transportation services to mission A

36. The Organization entered into a contract for the provision of fuel storage and transportation services at mission A for the period from 1 April to 31 December 1994. However, the contract was not signed until 30 May 1994. The request for proposal required the contractor to provide at least 30 to 40 full-time road tankers with a capacity of 5,000 United States gallons each.

37. According to the contractor's proposals, the price for delivering fuel to some 15 mission locations was set at a flat rate of \$550 or \$825, depending on distance, per trip, for 30,000 litres (7,921 gallons). However, the responsible Purchase and Transportation Service procurement officer omitted from the contract the quantity of fuel to be delivered per trip to the specified locations by substituting the phrase "per trip per drop-off" in the contract for "flat (rate) for

30,000 litres" as stated in the proposal. This change was made by the procurement officer based on his assumption that 7,921-gallon tankers could not be used for the specified deliveries, and also that the substance of the contract would not be changed.

38. In July 1994 the mission's contract administrator asked the Field Operations Division to define the term "trip". In October 1994 the Division noted that a trip should be defined as stated in the contractor's proposal, namely, 7,921 gallons per trip.

39. The OIOS resident auditor, who was assigned to the mission on a long-term basis, noted that from April to July 1994, average deliveries to the designated locations amounted to only 1,500 gallons per trip. The auditor also noted that through informal local arrangements, the contractor was being paid \$550 per trip for the delivery of approximately 700 gallons of fuel to local generators. The auditor recommended that all payments made to the contractor up to the time of the OIOS report in October be reviewed and overpayments recovered. Mission management agreed with the recommendation and, with Headquarters approval, withheld payments to the contractor pending resolution of the matter.

40. Another issue concerned fuel deliveries to more distant mission locations, which the contractor was supposed to make at delivery rates based on distance and estimated time per trip as spelled out in the contract. However, the Organization withheld payment of \$582,249 based on recommendations by the resident auditor and recalculation of the established distances by the mission contract administrator. OIOS noted in this regard that although the contractual formulation of prices was not precise, the mission had originally accepted the pricing arrangements. Differences in calculation methods had not been renegotiated and formally agreed to by the parties.

41. The third disputed amount (\$369,647) pertained to the fact that although the contract became effective on 15 March 1994, the contractor actually deployed its workforce on 1 March, and until 1 April 1994 was "understudying" and preparing to take over from the previous contractor. As a result, the Organization paid for this preparatory phase. The Organization also disputed charges of \$154,700 for miscellaneous services provided between April and December 1994.

42. Failing to settle its differences with the Organization, the contractor issued a demand for arbitration on 2 April 1996 for amounts totalling \$2,730,146. The Organization filed a counter-claim stating that the contractor had overstated invoices by \$2,693,100, and also made other

counter-claims totalling \$369,667, including \$300,000 for loss of fuel.

43. The arbitration tribunal awarded the highest disputed amount (\$1,345,025 in fuel transportation charges withheld by the Organization) in its entirety to the contractor. The tribunal did not accept that the United Nations officials who drafted the contract were unaware of the significance of changing the term "flat 30,000 litres" to "per trip per drop-off". The panel also noted that the mission had accepted the contractor's invoices for March to May 1994 on the basis of the contractor's interpretation of the price formulas. Also, some of the Organization's own witnesses had testified at the arbitration hearings that the contractor's charges appeared to be reasonable. The tribunal concluded that the contractor's invoicing conformed with the plain language of the contract.

44. The tribunal also rejected the Organization's arguments regarding its refusal to pay the contractor \$582,249 for fuel deliveries to various locations (see para. 40). It concluded that invoicing by the contractor had conformed with the contract, and found no basis for the Organization to recalculate the distances thereby contradicting the plain language of the agreement. The tribunal reduced the contractor's claim for \$369,647 withheld by the Organization to \$170,927 and decreased the other disputed amount of \$154,700 for miscellaneous services by about \$30,000.

45. The tribunal denied the Organization's \$300,000 counter-claim for the loss of fuel because the Organization could not prove the exact volume of the loss attributable to the contractor. However, the claim for the loss of trailers in the amount of \$30,000 was partially awarded to the Organization, and the claim for \$18,880 in truck rentals was awarded in full. The contractor agreed to pay \$5,787 for the loss of United Nations property.

46. The net amount due to the contractor was established at \$2,267,584. In addition, the tribunal awarded the contractor interest at the rate of 9 per cent per annum from 1 April 1995, contrary to the Organization's assertion that interest should be calculated from 2 April 1996 when the notice of arbitration was filed. Also, the Organization was ordered to pay all arbitration costs, totalling \$105,000, and 85 per cent of the contractor's legal costs, which amounted to \$229,381. The Organization's legal expenses totalled \$103,906.

47. OIOS believes that this dispute resulted from several factors including inadequate consultation among Headquarters and mission officials during contract preparation and execution. The Field Administration and

Logistics Division did not provide advice promptly on the questions raised by the mission, and did not effectively follow up on the issues. Further, advice should have been sought from the Office of Legal Affairs in a timely manner regarding the interpretation of ambiguous contract provisions and the potential implications of misinterpreting contract terms. The advice of the office of Legal Affairs should have been sought on the dispute well before the notice of arbitration was filed.

D. Supplying rations to missions B and C

48. This dispute involved two contracts with one supplier to provide food to the military contingents in two peacekeeping missions. The first of those contracts, signed in April 1993 and valid until October 1993, was not to exceed \$3,421,282. An amendment, which was signed retroactively in June 1994, extended the contract through February 1994. The second contract provided for a maximum of \$12,469,228, covering a 12-month period beginning in December 1993.

1. Mission B claims

49. The dispute at this mission arose when the contractor invoiced the Organization retroactively on a flat or fixed man-day rate rather than the previously used "ceiling man-day rate". Neither the contract nor its amendments stipulated such a rate change. The Organization rejected the claim. OIOS supports the Organization's decision and believes that claims for amounts not agreed to under the contract are unjustified. However, the contractor demanded and the arbitration tribunal awarded \$326,404 plus interest. The contract had stipulated an "all-inclusive man-day rate", a provision which could be interpreted either as a "ceiling man-day rate" or as a flat or fixed man-day rate.

2. Mission C claims

50. Although the contract stipulated a ceiling of \$12.5 million, invoices from the contractor totalled about \$19.5 million. The additional \$7 million had not been approved by the Headquarters Committee on Contracts in a formal contract amendment, although the contractor had alerted the Purchase and Transportation Service in August 1994 that the "contract ceiling would be exceeded shortly". Approximately \$4.3 million remained unpaid because of contractor non-performance. In this regard, the mission had identified several areas where the contractor's performance required improvement. These included discrepancies in rations orders, failure to wear protective clothing when

handling food, non-submission of progress reports, failure to unload deliveries and sub-standard quality of food.

51. The contract stipulated that defective products could be rejected and that the value of sub-standard products could be deducted from invoices. The unpaid invoices, totalling \$4.3 million, related to the contractor's unsatisfactory performance. Although this poor contract performance was documented repeatedly, the contractor was not formally advised of the reasons for non-payment. Furthermore, the food supplies were accepted and consumed on a regular basis by the mission. Accordingly, the Organization had no legitimate defence for its failure to pay the outstanding invoices, and the tribunal awarded the contractor 4,265,314 deutsche marks (DM) plus DM 1,492,051 in interest for the outstanding invoices (a total of \$3.2 million).

52. The contract stated that in the case of contractor non-performance and failure to bring performance into compliance with the contract within 15 days, the Organization could terminate the contract without prior notice. Also, if the mission had fully documented non-performance in detail, it could have had the option of reverting to the second-lowest bidder if a new bidding exercise had been deemed to be too time-consuming or disruptive. OIOS believes that the Organization was in a very difficult position because it did not adhere to its own procurement procedures and to the terms of the contract.

53. In 1994, the contractor delivered and the mission accepted food supplies not stipulated in the contract. In the opinion of OIOS, those shipments should have been rejected by the mission. Also, it was not clear whether those goods had been ordered by mission civilian personnel or by the military contingents, who did not have the authority to do so. OIOS believes that an inquiry should have been initiated to determine if that was the case, and if so, the responsible military contingent should have been asked for reimbursement. The tribunal awarded the contractor DM 84,200 (\$47,303) plus interest. It appears that this amount was indeed payable to the contractor since the goods, although not ordered under the terms of the contract, were nonetheless accepted and consumed by the mission.

54. The contractor claimed and was awarded DM 1.1 million (\$629,213) for additional food supplies imported in anticipation of a contract extension and related warehousing costs. The contractor contended that he had been assured both orally and in writing that the existing contract would be extended for about 3.5 months because of satisfactory performance. Since the supplies could not be re-sold owing to customs regulations and because the Organization refused to buy them, they were abandoned or donated locally. The

claim was rejected by the Organization. However, the tribunal awarded DM 336,000 (\$188,764) to the claimant without interest, stating that payments for the food and its warehousing were interrelated, although there was no adequate evidence that the contractor had maintained warehouses longer than necessary.

55. The tribunal awarded the contractor DM 390,000 (\$219,100) for gains in foreign exchange due to the strengthening of the United States dollar against the German mark during the dispute. Although the contract stipulated relevant amounts in dollars, there was no contract provision specifically limiting the contract currency to dollars, and the contractor invoiced the Organization and was paid in marks. Prior to signing the contract, the contractor had written to the Acting Chief of the Purchase and Transportation Service requesting that all monetary amounts be changed to marks. The contractor signed the contract after the Acting Chief confirmed in writing that such a change was acceptable and would be made through a contract amendment. Although the formal amendment was not made, the tribunal viewed the exchange of correspondence as an acceptance by the Organization of the change in currency.

56. The claimant argued that as a result of the dollar's appreciation, the Organization profited while the dispute was being resolved, and should be penalized. The United Nations strongly objected to the contractor's claim for such an exchange-rate benefit, arguing that the contractor bargained for payment in marks and not dollars, thus making exchange rates irrelevant, and that payment of interest was the appropriate legal remedy for payment delays. The tribunal found for the contractor despite a strongly worded dissent by the United Nations-appointed arbitrator. OIOS believes that this issue should have been resolved during implementation of the contract.

3. Other claims

57. The contractor claimed a minimum of approximately DM 35.3 million (\$23.2 million) for damages allegedly resulting from the Organization's failure to adhere to its commercial agreements with the company. The claimant argued that it was blacklisted by the Organization and was not allowed to bid on contracts. The contractor asserted that the company should be reinstated on the Organization's vendor roster and allowed to participate in procurement activities. It appears, however, that the vendor was never actually removed from the roster. The tribunal was asked to rule on the transparency and objectivity of the Organization's procurement system, but declared itself not competent to rule on internal matters and dismissed the

claim. However, it should be noted that the quality of the vendor roster remains a matter of continuing concern to Member States and OIOS. Contractors with sub-standard performance records should be disqualified from further bidding on contracts, and the roster should include only reliable contractors. All instances of non-performance should be recorded in the procurement database and documented in the vendor file.

58. The contractor also claimed \$140,449 for legal fees and related costs. The claim was rejected by the tribunal. Overall, the tribunal awarded the contractor DM 8,294,810, or \$4,688,808, which was far less than the "over DM 35 million" claimed by the contractor in its statement of claim. The total award was about \$225,000 more than the Organization had offered the contractor to settle its claim in December 1995, prior to arbitration.

E. Air transport services at missions B, D and E

59. An amended notice of arbitration was filed by a contractor for \$1,763,414 regarding three contracts for air transport services at three peacekeeping missions. In addition, the notice included a claim for \$956,405 by a group of insurance underwriters. The contractor's claims involved such matters as early contract termination by the Organization, non-payment of insurance, lost revenue caused by damage to the aircraft and failure of the Organization to pay the contractor during periods when the contractor could not operate because of the lack of flight clearance. The insurance underwriters' claim was for payments made to the contractor for aircraft repairs.

60. OIOS noted that the claims were partly attributable to accidents in which two helicopters were damaged. The first accident was a collision involving negligent driving by a member of a military contingent who was not authorized to drive the mission's vehicles and did not have a valid driver's licence. It was not clear if there had been a board of inquiry review or if the damages were charged to the contingent. The second incident involved an accident by a mission forklift operator who unloaded a helicopter, even though the contract stipulated that the contractor was responsible for the unloading.

61. Both claimants also sought interest on the amounts claimed as well as arbitration costs, attorney's fees and other relief. Negotiations were conducted during 1995 and 1996, and arbitration proceedings were avoided. A settlement agreement was reached in September 1996 under which the

Organization agreed to pay a total of \$1.25 million to both claimants. However, it was not possible to determine from the available documentation how the two claimants shared the payment, since the settlement agreement provided for a lump-sum payment to the contractor acting on behalf of both claimants.

III. Conclusions and recommendations

62. Despite the relatively small number and monetary value of the disputed cases in relation to overall expenditures, OIOS noted that substantial additional costs were incurred as a result of settlement agreements and arbitration cases. Those additional costs, which in most cases involved interest charges for delayed payments, legal fees and significant staff costs, can be attributed to several factors. The major factors are unclear contractual terms that become subject to different interpretations, non-compliance with procurement rules and procedures by the mission procurement staff and inadequate contract administration in the field.

63. OIOS believes that in order to avoid costly litigation and to mitigate financial consequences to the Organization when litigation is unavoidable, several steps should be taken in the procurement and contract management areas. OIOS recommends the following:

- *Recommendation 1.* The Field Administration and Logistics Division should ensure that peacekeeping missions, especially during start-up, are staffed with qualified and experienced personnel in key procurement and contract administration positions as well as with qualified legal advisers. Those personnel should be able to provide necessary guidance and training to other staff under their supervision. Consideration should be given to seconding qualified Headquarters procurement officers to the missions (AP98/125/1/001);
- *Recommendation 2.* The Field Administration and Logistics Division, in cooperation with the Procurement Division, should issue clear guidelines to procurement and contract administration personnel on documenting deviations by contractors from contractual terms. Any deviations or queries about differing interpretations of contractual terms that cannot be resolved in the field should be brought to the attention of the Procurement Division and the Office of Legal Affairs as soon as possible (AP98/125/1/002);

- *Recommendation 3.* The Procurement Division should refer major non-standard contracts to the Office of Legal Affairs for review to avoid unclear formulations that could be interpreted differently by the parties and cause disputes during implementation that could result in litigation (AP98/125/1/003);
- *Recommendation 4.* The Field Administration and Logistics Division and the Procurement Division should refrain from disclosing to contractors the financial resources available for individual contracts and ensure that payments are based on duly certified invoices in accordance with all contractual terms (AP98/125/1/004);
- *Recommendation 5.* Peacekeeping missions and the Procurement Division, in cooperation with the Field Administration and Logistics Division, should routinely evaluate and document unsatisfactory vendor performance and use those evaluations in procurement decision-making (AP98/125/1/005);
- *Recommendation 6.* Undisputed payments for goods and services delivered in accordance with contractual terms should be made promptly to avoid claims for interest payments. In consultation with the Office of Legal Affairs, payments should be withheld only where appropriate to safeguard the interests of the Organization in the event that claims are made against a contractor. Contractors should be fully informed in writing of the reasons for non-payment (AP98/125/1/006);
- *Recommendation 7.* The Field Administration and Logistics Division should ensure that all losses caused by third parties are promptly charged to those parties (AP98/125/1/007);
- *Recommendation 8.* The General Legal Division, the Procurement Division and the Field Administration and Logistics Division should review all aspects of arbitration and settlement cases to identify lessons learned, and should disseminate them to peacekeeping missions and other key participants in the procurement process (AP98/125/1/008).

The General Legal Division, the Procurement Division and the Field Administration and Logistics Division commented on a draft of the present report, and generally agreed with the findings and recommendations. With regard to recommendation 1, the General Legal Division commented that having experienced procurement, contract administration and legal personnel in the missions is important at all times. The Office of Legal Affairs had

explored the possibility of rotating its attorneys to the field and bringing mission legal advisers to the Office for limited periods. OIOS supports that initiative. With regard to recommendation 8, the Office of Legal Affairs pointed out various initiatives by the General Legal Division to identify and disseminate lessons learned from arbitration cases. Still, the Office acknowledged that more could be done in that respect.

With regard to recommendation 4, the Department of Management commented that the implications of not providing contractors with the financial limits should be reviewed jointly by the Procurement Division, the Field Administration and Logistics Division and the Office of Legal Affairs to determine this recommendation's practicality from a legal, administrative and budgetary perspective. OIOS expects to be informed of the results of this review.

The Department of Peacekeeping Operations noted that achievement of the goals recommended by OIOS would depend on the provision of adequate resources to develop the automated systems and staff capabilities required. In that regard, OIOS believes that implementation of recommendations 1 and 5 might require additional resources for which the Department should prepare a detailed justification. The remaining recommendations, in the opinion of OIOS, can be implemented with the Organization's existing resources. The Department also suggested that an internal mechanism be developed to resolve commercial disputes in a more timely and cost-effective manner rather than resorting to arbitration proceedings. OIOS concurs with that suggestion.

(Signed) Karl Th. Paschke
Under-Secretary-General for
Internal Oversight Services